

An abating recovery

After a GDP increase of 0.2% in Q1 2010, economic prospects in the euro-zone remain subdued. Real GDP is forecasted to accelerate, +0.5%, in Q2 2010 and then to decelerate, +0.3% and +0.2% in Q3 and Q4 2010, respectively. Despite strong readings from surveys in Q2, several factors would weigh on growth in H2: fading fiscal stimulus in the coming quarters; fiscal consolidation; the still restrictive credit conditions and increased financial market uncertainty following the recent sovereign-debt crisis. After the strong increase by 4.1% in Q1 2010, industrial production is likely to lose momentum over the forecast horizon: the current business climate is still below its historical average. Private consumption is expected to almost stagnate (+0.1% per quarter) due to less supportive fiscal policies, high unemployment rate and increasing precautionary savings. Investment is expected to rebound at a rate of 1.0% in Q2 2010 due to a weather-related postponement of construction investment in Q1 2010. Thereafter the low degree of capacity utilization and the still restrictive credit supply will dampen investment growth which is expected to moderate to 0.4% in both Q3 and Q4 2010. On the assumption that in Q3 and Q4 2010 the oil price will stabilize at USD 75 per barrel of Brent and that the dollar/euro exchange rate will fluctuate around 1.22, inflation should move to 1.7% in September and to 1.6% in December 2010.

Industrial production decelerates

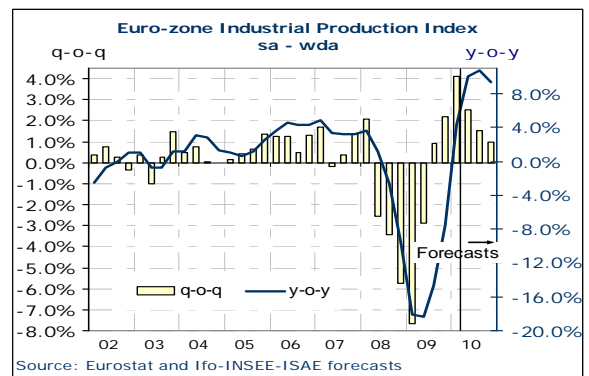
After the healthy increase by 2.2% in the last quarter of 2009, industrial production rose even more strongly in Q1 2010 (4.1%). This rebound was mainly driven by the dynamic external demand mostly coming from emerging Asia and Latin America. In the coming quarters, industrial production is expected to decelerate. The austerity measures to be introduced in many member states are likely to exert a dampening effect on domestic demand. Furthermore, growth in many emerging economies is expected to moderate in the second half of 2010. However, better economic outlook, as pointed by many business surveys and improved competitiveness of European products due to the relatively weak euro, would together support industrial production growth. All in all, industrial production is forecasted to increase by 2.5% in Q2 2010, and then 1.5% and 1.0% respectively in Q3 and Q4 2010.

A fragile GDP recovery

Real GDP in the euro-zone rose in Q1 2010 by 0.2% after an increase of 0.1% in Q4 2009. Activity grew thanks to a stronger government spending and to exports while internal demand contracted slightly. Investment decreased due to exceptionally bad weather conditions while private consumption stagnated.

Private consumption is expected to expand only modestly over the forecast horizon. Slack in the labour market will likely lead to a moderation in nominal wages while hiring prospects remain subdued. The increasing fiscal consolidation

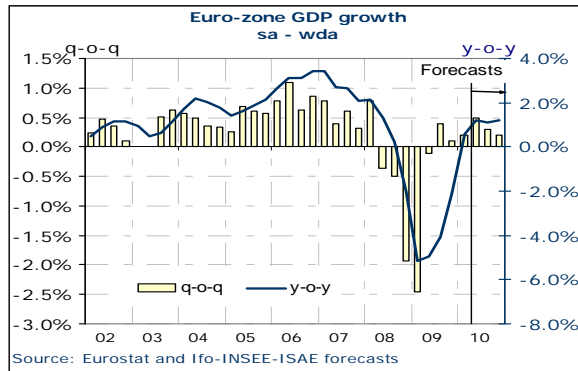
efforts in most member countries will weigh on the growth of current as well as expected future disposable income. All in all, private consumption is expected to rise very modestly, at a rate of 0.1% in Q2, Q3 and Q4 2010.



In the coming quarters, investment is likely to recover only modestly. Earning prospects of firms have recently improved, but overall production capacity is still under-utilized and credit conditions should remain restrictive due to ongoing balance-sheet repairs by banks. Moreover, increased uncertainty and fears of additional write-offs following the sovereign debt crisis are likely to further weaken credit supply. However, due to a weather-related postponement of many projects in Q1, construction investment should strongly accelerate in Q2. Overall investment is expected to rebound by 1.0%, in Q2 2010 before slowing down to 0.4% in both, Q3 and Q4 2010.

Association of Three Leading European Economic Institutes

In sum, over the forecast horizon domestic demand will remain weak while external demand and investment should provide the major positive impulses to economic activity in the Euro-zone. Real GDP is forecasted to expand at rates of 0.5% in Q2 2010, 0.3%, in Q3 2010 and 0.2% in Q4 2010.

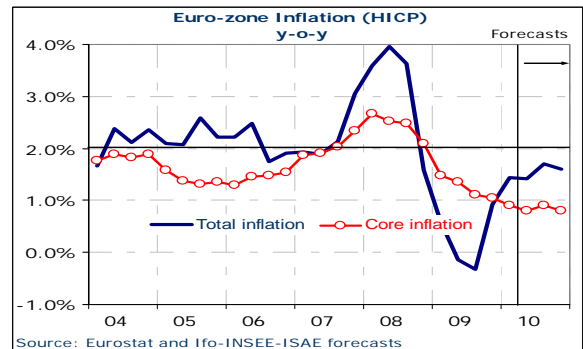


The severe fiscal situation in several member states still poses a potential risk to our scenario. Increasing risk premiums in the interbank and the sovereign-bond markets indicate persistent concerns about the sustainability of the public debt in some peripheral countries in the Euro-zone. A renewed instability in financial markets can still not be ruled out.

Inflation should stabilize over the forecast horizon

Euro-zone headline inflation was 1.4% in June, down from 1.6% in May and 1.5% in April. This decrease was to a large extent driven by the moderation of energy and food prices. Inflation is expected to remain relatively stable over the course of 2010 due to the counterbalancing

effects of a weak domestic demand on the one hand and the diffusion of rising commodity and imported goods' prices on the other. On the assumption that the Brent oil price will stabilize at 75 USD and that the dollar/euro exchange rate will fluctuate around 1.22, headline inflation is forecasted to increase to 1.7% in September and then fall back to 1.6% in December 2010. Core inflation will also remain relatively stable in the coming quarters.



2010 Forecasts, % changes, sa - wda

q-o-q y-o-y	Q1-2010	Q2 - 2010 forecasts	Q3 - 2010 forecasts	Q4 - 2010 forecasts
IPI	4.1 4.3	2.5 10.0	1.5 10.7	1.0 9.4
GDP	0.2 0.6	0.5 1.2	0.3 1.1	0.2 1.2
Consumption	-0.1 0.0	0.1 0.0	0.1 0.3	0.1 0.2
Investment	-1.2 -4.8	1.0 -2.5	0.4 -1.0	0.4 0.6
Inflation*	1.4	1.4	1.7	1.6

Source: Eurostat and Ifo-INSEE-ISAE forecasts; * end-of-quarter

Methodological note

This quarterly publication is prepared jointly by the German Ifo institute, the French INSEE institute, and the Italian ISAE institute. The forecasts are produced with the help of tools shared by the three institutes, using time-series models based on business surveys by national institutes, Eurostat, and the European Commission. Our joint two-quarter-ahead forecast covers euro-zone industrial production, GDP, consumption, investment, and inflation. Publication is timed to coincide with Eurostat's second release of quarterly national accounts.

Fuller economic analysis for each country (Germany, France, Italy) is available in:

- [Ifo Konjunkturprognose](#), Ifo
- [Conjoncture in France](#), INSEE
- [Abridged Quarterly Report](#), ISAE

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Next release:

October 6, 2010 (date of Eurostat's second release of quarterly national accounts)

Next forecast horizon:

2011 Q1